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IN THE

Supreme Court of the United States

OCTOBER TERM, 1959

No. 623

TINNERMAN PRODUCTS, INC.,
Petitioner,
vs.
PRESTOLE CORPORATION,
Respondent

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT

BRIEF FOR RESPONDENT IN OPPOSITION

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FIRST QUESTION PRESENTED

May petitioner, as licensor, enforce a patent license contract which precludes the licensee from incorporating in the licensed devices a feature of one of petitioner's patents that had expired prior to the date of the license.

SECOND QUESTION PRESENTED

Where a patent license agreement provides that the licensee (respondent) shall pay licensor (petitioner) a royalty of 5% of its net sales of the licensed devices and further provides that in the event licensor "grants a license with more favorable royalty terms" to a third party, licensor will within thirty days deliver a copy of the agreement to licensee and licensee "shall then have thirty days in which to determine whether it desires to adopt such terms," and the licensor thereafter grants a patent license to a third party along with the right to use a valuable trademark and further agrees to and does furnish the third party complete and continuous engineering services relating to the design and manufacture of the licensed devices and charges the third party a single royalty of 6% of its net sales for all the granted rights, and licensor did not deliver a copy of the third-party license agreement to licensee or inform licensee of its terms or give licensee an opportunity to adopt any advantageous terms of the third-party license, should the value of the trademark license and the engineering services, which were not granted the licensee, be deducted from the 6% royalty payable by the third party in order to determine whether the actual royalty paid by the third party for the patent license was less than the 5% charged licensee.

THIRD QUESTION PRESENTED

May petitioner enforce a patent license agreement which contains no price restrictions after petitioner entered into a price-fixing license agreement with a third party involving the same patents, particularly where the grant of the third-party license constituted one of several steps taken

in conjunction with the third party in an attempt to force respondent out of business.

FOURTH QUESTION PRESENTED

May respondent defend petitioner's suit for royalties under a license contract by showing that the licensed patents are invalid in view of the fact that petitioner has entered into a price-fixing license agreement with a third party involving the same patents.

STATUTES INVOLVED

In addition to the statutes noted in the petition, there is involved the Sherman Act, namely, the Act of July 2, 1890, C647, 26 Stat. 209; 15 USC1-7, as amended, the relevant portion of which reads as follows:

> "Sec. 1. Every contract, combination in form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several states, or with foreign nations, is declared to be illegal: * * *."

STATEMENT AS TO FIRST QUESTION

The first question relates to the right of petitioner to enforce a contract which restrains use of the subject matter of one of petitioner's expired patents.

Since about 1923 petitioner has engaged in the manufacture and sale of sheet metal fasteners which are like an ordinary nut in that they have an opening which receives a threaded bolt or screw. The thread engaging portion of the fasteners at the opening comprises a pair of tongues which project toward each other and their ends

are notched out and formed with screw thread engaging edges. In 1924 petitioner received a patent, No. 1,512,653 (D. Ex. 15, R. 32a, 163a) covering this type of thread engaging portion, but that patent expired on October 21, 1941.

Prior to August 18, 1942, which is the date of the contract in suit, respondent's predecessor was making sheet metal fasteners which were like those made by petitioner except that they had a different form of thread engaging portion.

On August 18, 1942, the parties entered into several agreements, one of which was the license contract in suit (P. Ex. 2, R. 27a, 114a). That agreement contained the following granting clause:

> "1. Tinnerman hereby grants unto Detroit Harvester a non-exclusive right and license to make or to have made, and to use and to sell devices embodying the inventions covered by the said patents above described or any of them including any and all reissues and/or extensions of term thereof upon the terms and conditions hereinafter set forth. Provided, however, that this license shall not include devices covered by said patents in which the thread-engaging portion comprises a pair of tongues, the ends of which are notched out and formed with screw thread engaging edges intended for and used to receive a screw such as shown and described in Tinnerman Patents Nos. 1,512,653; 1,928,469; 2,221,498; and 2,233,230."

It will be observed that Detroit Harvester, which was respondent's predecessor, was precluded from using in the licensed fasteners the form of thread engaging portion which comprised a pair of tongues "as shown and described" in the petitioner's then expired patent 1,512,653.

By this provision, petitioner made sure that when respondent used the licensed improvement patents it would have to refrain from using the tongue type thread engaging form of the expired patent.

The court of appeals held that this constituted a misuse of the licensed patents which precluded petitioner from enforcing the license agreement in suit and for that reason entered judgment directing the district court to dismiss petitioner's action for specific performance (petition pp. 30-34 and 38).

STATEMENT AS TO SECOND QUESTION

The second question relates to respondent's principal defense to the present action, namely, that petitioner breached the contract and is therefore not entitled to enforce it. This defense was sustained by the court of appeals. It involves a question of contract construction, set forth as question 2.

The principal facts established by the record are stated in the opinion of the court below, but will be repeated here in order to cite the supporting portions of the record.

The license agreement of August 18, 1942, in suit (P. Ex. 2, R. 27a, 114a-118a) requires the licensee, respondent, to pay royalties at the rate of 5% of its net sales of the licensed fasteners ;and it includes the following provision:

> "12. In the event that Tinnerman grants a license with more favorable royalty terms, then within thirty (30) days of the execution of such license a copy shall be delivered to Detroit Harvester and Detroit Harvester shall then have thirty (30) days in which to determine whether it desires to adopt such royalty terms."

On August 30, 1946, petitioner and Illinois Tool Works ("Shakeproof" Division) entered into a patent license agreement (D. Ex. 8, R. 37a, 144a-151a) and a few days later entered into supplementary agreements (D. Ex. 9, R. 37a, 152a, Adm. 32, R. 37a, 236a, and Adm. 43, R. 37a, 239a). These agreements, which obviously constitute parts of a single transaction, contain as their principal provisions the following:

(a) A nonexclusive license in favor of Illinois Tool Works under a total of twenty patents, including the only two patents now involved in this suit.

(b) A requirement that Illinois Tool Works pay a royalty of 6% of its net sales of the patented fasteners.

(c) A requirement that Illinois Tool Works shall not sell the patented fasteners at prices less than the prices at which they were sold by petitioner (D. Ex. 8, par. 7, R. 146a-147a).

(d) An agreement upon the part of petitioner to "assist" Illinois Tool Works "with such information as it may have in order that production can commence as rapidly as possible" (D. Ex. 8, par. 16, R. 149a-150a). Under this provision petitioner furnished throughout the nine-year period from 1946 to 1955 all technical and engineering information, drawings, and the consulting services of its employees which were necessary to enable Illinois Tool Works to manufacture the patented fasteners in forms which were identical to those of petitioner. No payments other than royalties were made for this assistance and information (Adm. 38-54, R. 37a, 238a-242a).

(e) Illinois Tool Works was given the right to use petitioner's trademark SPEED NUTS on fasteners covered by the licensed patents (D. Ex. 9, R. 37a, 152a, and Adm. 32-34, R. 37a, 236a-237a). The trademark SPEED NUTS is the principal trademark under which petitioner sells its fasteners and is an important asset of its business (Adm. 36, R. 37a, 237a).

Evidence, too extensive to outline here, was adduced by respondent to show the value of the engineering services and the fact that in this line of business each fastener is specially designed and formed for a specific mass production application, so that engineering expense in connection with the design and manufacture of the licensed fasteners is a continuing expense which, like a royalty, is proportional to the extent of use of the license. It is respondent's position that the engineering services furnished by petitioner to Illinois Tool Works were, alone, worth the full 6% royalty paid by Illinois Tool Works and that therefore Illinois Tool Works was actually granted a royalty-free license. The court of appeals held that this evidence showed that petitioner "intended to, and did, provide more favorable royalty terms to Illinois" (petition p. 27).

Petitioner, in its statement as to the second question, states that respondent knew of the existence of the Illinois Tool Works agreement. This is true only to the extent that respondent learned from press releases that a license had been granted. But respondent knew none of the terms of the license until just prior to suit (1954) and did not learn of the trademark license nor of the extent of the engineering services supplied Illinois until after suit was filed. No copies were ever "delivered" to respondent as required by the contract (D. Ex. 4, 5, 6 and 7, Adm. 24-28, R. 37a, 235a-236a).

The court of appeals held that the failure of petitioner to make available to respondent the more favorable royalty terms of the Illinois license constituted a breach of the contract and for that reason directed the district court to dismiss the action to enforce the license contract.

STATEMENT AS TO THIRD QUESTION

Respondent urged below that the suit should be dismissed because petitioner had misused the licensed patents by entering into a price-fixing license agreement with Illinois Tool Works relating to the same patents after granting an unrestricted license to respondent.

The Illinois Tool Works license is in evidence as D. Ex. 8, R. 37a, 146a-147a. It contains the following provision:

> "7. As long as Tinnerman shall continue to manufacture and sell fastening devices covered, as an article of manufacture, by one or more unexpired patents of the aforesaid United States patents, Illinois will refrain from selling fastening devices covered by the same one or more unexpired patents at prices less than, or on terms and conditions more favorable to the purchaser than, prices computed in accordance with the standards and differentials used by Tinnerman and the terms and conditions used by Tinnerman, in selling fastening devices covered, as an article of manufacture, by the same one or more unexpired patents. In order that Illinois may be kept informed as to the minimum prices at which it may sell fastening devices manufactured by it under this license, Tinnerman will notify Illinois from time to time of Tinnerman's selling prices for such fastening devices and the standards and differentials used in computing said prices, and will give Illinois advance notice in writing of any change in Tinnerman's selling price."

It is admitted that this provision of the agreement was complied with (Adm. 4-7, R. 37a, 230a-231a). About a year later the parties entered into a supplemental agreement to the effect that if the price maintenance provision was held invalid all other provisions should remain in force (D. Ex. 10, R. 37a, 153a-154a).

It is respondent's contention that at the date of execution of the Illinois Tool Works agreement petitioner had already bargained away its right to be free of price competition on its sales of the licensed fasteners by granting an unrestricted license to respondent. Therefore it cannot justify its price-fixing agreement with Illinois Tool on the basis of its patent monopoly.

This defense was not sustained by the court of appeals (petition pp. 34-36), but it constitutes a proper ground for affirming the judgment below.

STATEMENT AS TO FOURTH QUESTION

Respondent urged below that even if petitioner's price-fixing agreement with Illinois Tool Works was valid on the assumption that the patents were valid, it was clearly a violation of the Sherman Act if the patents were invalid; and that therefore respondent should be permitted to defend the action by showing the invalidity of the licensed patents.

This contention was rejected by the court of appeals, but it constitutes a ground for supporting that portion of the judgment which reverses the district court's judgment on the contract action, and would justify a remand for determination of the validity of the patents.

ARGUMENT

A. The Second Question Is Determinative of the Petition

This is a suit for specific performance of an agreement to account for and pay royalties on sales of patented fasteners, which the court of appeals struck down for *two* reasons—either one of which was sufficient for the purpose. Hence, to benefit petitioner it is necessary to overrule the court of appeals on both of the questions presented by the petition and also to rule adversely to respondent on the third and fourth questions presented in this brief. To deal with only one is to deal with what may be a moot question.

The court of appeals held that petitioner was not entitled to a decree of specific performance because it had been guilty of an intentional and substantial breach of the agreement by failing to give respondent the benefit of more favorable royalty terms granted a third party. This was the principal defense urged below. Petitioner denies the breach, and this phase of the controversy raises the "second question" set forth in the petition.

The second question involves nothing more than the construction of a private contract and its application to an unusual fact situation. No federal question is involved. No conflict of authorities is cited. No claim is made that the court below indulged in any improper procedure. And no attempt is made to show that there is any public interest at stake or even that the contract language in question has been used by other parties. There is thus no ground for granting the petition.

Moreover, the ruling of the court of appeals on the second question is obviously sound and supports the judgment regardless of any other questions that may be raised. This Court has said that it would not review a lower court on writ of certiorari if the decision below "may be supportable as a matter of state law, not subject to review by this Court," even though the lower court also passed on issues of federal law. *Maryland v. Baltimore Radio Show*, 338 US 912.

As far as the merits are concerned, the court of appeals accepted as controlling the decisions relied upon by the district court as to the construction of the term "royalty," but merely held, in effect, that the 6% royalty paid by Illinois Tool Works had to be allocated between patent royalty and engineering service fee to determine what portion of the total constituted the actual royalty paid for the patent license. In doing so it applied the principle of *Corn Products Refining Co. v. Federal Trade Commission*, 324 US 762, in which this Court held that there was price discrimination in favor of a buyer to whom the seller furnished services at no additional charge as compared to other buyers who paid the same price but received no services.

Petitioner contends that the contracts in question contain many provisions and conditions and that the court of appeals in effect held that all are to be considered as encompassed within the expression "royalty terms." It may well be that all should be so considered, but the court of appeals did not do so. On the contrary, it was careful to point out that the engineering services supplied were continuing services related to the extent of use of the license and therefore had a direct effect on the cost of exercising the license, as distinguished from other provisions which

"do not add to, or take away from, the price or consideration to be paid for use of the license" (quote from the opinion below, at page 30 of the petition).

As stated by the court below:

> "The obvious intent and purpose of paragraph 12 of the contract was to protect Prestole against a possible competitive disadvantage in the event of a license to a third party. It paid for such protection. Such was a reasonable and proper objective, and language employed should not be narrowly construed to frustrate that objective. We should look at the entire contract between Tinnerman and Illinois to see whether or not more favorable royalty terms were created by it."

B. As to the First Question

Petitioner enjoyed a seventeen-year monopoly under expired patent 1,512,653. Thereafter, by granting a license authorizing respondent to use the subject matter of subsequent improvement patents, but only so long as the licensed devices did not have thread engaging portions in the form of the tongues of the expired patent, petitioner was clearly guilty of using (or misusing) the licensed patents to restrain competition in the subject matter of the expired patent.

Petitioner asserts that there was no contract prohibition against use of the thread engaging tongues of the expired patent and therefore if respondent had used those tongues in fasteners of the type covered by the licensed improvement patents, petitioner's sole remedy would have been to sue for infringement of the licensed patents. If this be true it only means that if the licensed patents were held valid in such a suit petitioner would have succeeded in its

attempt to use them to restrict use of the tongues of the expired patent.

This is clearly contrary to the principles enunciated by this Court in *Scott Paper Co. v. Marcalus Mfg.*, 326 US 249, 256-257, as follows:

> "It is thus apparent that the patent laws preclude the patentee of an *expired* patent and all others including petitioner from recapturing any part of the former patent monopoly; for those laws dedicate to all the public the ideas and inventions embodied in an expired patent. They do not contemplate that anyone *by contract or any form of private arrangement* may withhold from the public the use of an invention for which the public has paid by its grant of a monopoly and which has been appropriated to the use of all. The rights in the invention are then no longer subject to private barter, sale, or waiver." (Emphasis added.)

Those principles were also stated in a somewhat different way by this Court in *Ethyl Gasoline Corp. v. United States*, 309 US 436, 456, as follows:

> "He (the patentee) may not . . . condition the license so as to control conduct by the licensee not embraced in the patent monopoly. *Standard Sanitary Mfg. Co. v. United States*, 226 U. S. 20, 57 L. ed. 107, 33 S. Ct. 9; *Interstate Circuit v. United States*, 306 U. S. 208, 228-230, 83 L. ed. 610, 621, 622 . . ."

Petitioner asserts in support of its petition that the question is important inasmuch as it concerns the right of a patent owner to grant a limited license under the patent. However, this is stating the case much too broadly. In this case the effect of the limitation was to continue in a very effective manner—at least as to respondent—the

monopoly which petitioner had enjoyed under its expired patent. The court below, in striking down that limitation, did not challenge the validity of other and more common types of limitations in patent licenses, such as limitations as to territory, size, field of use and the like. It merely held invalid a limitation which is contrary to public interest. To that extent limitations in licenses have already been outlawed by this Court, and there is no need for this Court to review the lower court's application of those principles to the facts of this case.

Petitioner erroneously asserts that respondent included a similar limitation in a patent license it granted petitioner under some of respondent's patents. The fact is the license from respondent (P. Ex. 7, R. 129a) did not preclude use of the subject matter of any expired patent, and certainly not the subject matter of the expired Lehman patent 1,457,039 (R. 159a) as suggested by petitioner. Moreover, even if respondent had been guilty of a similar wrong that would not cure the defect of the contract in suit.

C. As to the Third Question

"In the absence of patent or other statutory authorization, a contract to fix or maintain prices in interstate commerce has long been recognized as illegal per se under the Sherman Act." *United States v. Line Material Co.*, 333 US 287, 307.

Petitioner seeks to justify its price maintenance agreement with Illinois Tool on the authority of this Court's decision in *United States v. General Electric*, 272 US 476. But this Court in the *Line Material* case held that the rule of *General Electric* should be limited strictly to the facts of that case, and the rationale of the *General Electric* case is not applicable here. In *General Electric*, this Court, in

discussing the right of a patentee to control his licensee's selling price, said (272 US 490):

> "We think he may do so provided the conditions of sale are normally and reasonably adapted to secure pecuniary reward for the patentee's monopoly."

Here, however, the petitioner had already bargained away its right to be free of price competition by granting respondent a nonexclusive license without price restrictions. Having done so, its subsequent price-fixing agreement with Illinois Tool Works cannot be justified as a means to preserve petitioner's patent monopoly.

The court of appeals overruled this defense, holding that the *General Electric* case was controlling, apparently basing its decision on the absence of proof that either petitioner or Illinois Tool controlled any substantial part of the industry. But this overlooks the fact that price-fixing agreements are per se violations of the Sherman Act. Moreover, the evidence in this case supports the conclusion that the objective of petitioner in making its agreement with Illinois Tool was to eliminate the price competition of respondent. This cannot be justified by the patent laws because respondent held a license under the patents.

Accordingly, even though the decision of the court of appeals on the first and second questions be considered erroneous the judgment should be affirmed on the ground that petitioner has misused the licensed patents by its price-fixing agreement with Illinois Tool Works.

D. As to the Fourth Question

If the licensed patents are invalid, as contended by respondent, the price-fixing agreement between petitioner and respondent is clearly void. Therefore, under the doctrine of *Katzinger v. Chicago Metallic Mfg.*, 329 US 394, the respondent should not be subject to the estoppel which normally precludes a licensee from defending a suit for royalties by proof that the patents are invalid.

The court below held that the *Katzinzer* case was not applicable because the contract involved in this suit did not contain a price-fixing provision. However, it would seem strange to give a licensee who is party to an illegal price-fixing license agreement more favorable treatment than an innocent licensee, where the two licenses involve the same patents.

Accordingly, it is requested that in the event this Court grants the petition, it consider the fourth question raised by this brief and remand the case for determination of the validity of the licensed patents.

CONCLUSION

For the foregoing reasons it is respectfully submitted that this petition for a writ of certiorari should be denied.

Respectfully submitted,

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REPLY BRIEF FOR PETITIONER.

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REPLY BRIEF FOR PETITIONER.

RESPONDENT'S FIRST QUESTION.

Respondent, in its form of question, asserts that the patent license contract "precludes" the licensee from incorporating, in the licensed devices, a feature of one of Petitioner's expired patents. This is improper, because it begs the question by assuming that the contract in question does in fact "preclude" the licensee from making a licensed device. In our submission the language used in the contract precludes nothing, and in the absence of such preclusion there can be no misuse.

RESPONDENT'S SECOND QUESTION.

The phraseology of Respondent's second question is disputed insofar as concerns the allegation that Respondent was not informed of the terms of the third party agreement, and insofar as the licensee would have a right to adopt any "advantageous" terms of the third party license. The record* clearly shows that Respondent was given an

* (DX-11, R. pp. 155a, 156a; DX-12, R. p. 157a, and DX-25, R. p. 231a.)

opportunity to adopt the price maintenance provision of the third party contract, but rejected it. It is Petitioner's contention that the provisions of the third party contract are not severable and that the rejection by Respondent of one material provision was adequate in law to satisfy the provision in Respondent's license that it chose not to adopt the terms of the Illinois Tool Co. license.

Respondent, by paying royalties for about ten years after its rejection of the aforesaid price maintenance provision, adequately demonstrated the fact that Petitioner committed no breach of agreement.

RESPONDENT'S THIRD AND FOURTH QUESTIONS.

Respondent's third and fourth questions were decided adversely to Respondent by the Court of Appeals. Respondent has filed no cross-petition for certiorari hence such questions are not to be considered in this proceeding. *Morley Construction Co. vs. Maryland Casualty Co.*, 300 U. S. 185, 191 and cases cited. *Le Tulle vs. Scofield*, 308 U. S. 415, 421-422.

CONCLUSION.

For the foregoing reasons, and for the reasons stated in the Petition and Brief in Support thereof, it is respectfully submitted that the Petition should be granted.

Respectfully submitted,

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